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**Amended Provisional Authorisation  
Compliance Statement 2005**

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**Statement amended 16 February 2006**

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**Commerce Act (Natural Gas Services)**

**Provisional Authorisation 2005**

**CERTIFICATION OF COMPLIANCE STATEMENT**

We, *Euan Richard Krogh* and *Seamus Egan. O'Keefe*  
being directors of Powerco Limited, certify that, having made all reasonable enquiry, to  
the best of our knowledge and belief and based on the gas volumes known to Powerco at  
7 September 2005 the attached compliance statement of Powerco Limited, and related  
information, prepared for the purposes of the Commerce Act (Natural Gas Services)  
Provisional Authorisation 2005 complies with the requirements of that authorisation.

16 February 2006

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## 1. EXECUTIVE SUMMARY

This document contains information relating to the price threshold and quality standards required to be disclosed under clause 7 of the *Commerce Act (Natural Gas Services) Provisional Authorisation 2005* (the "Notice").

Powerco Limited ("Powerco") has complied with the price threshold as set out in clause 5(a)(i) and 5(b) of the Notice as at 1 October 2005. That is:

- The price for each standard service remained the same throughout the initial period;
- The notional revenue at the 1 October 2005 assessment date did not exceed the notional revenue allowed under the price path. Based on a strict application of the Notice formula Powerco reduced its notional revenue by 65.4%.

Powerco has complied with the spirit of clause 5(a)(ii) however a single contract for non-standard services entered into prior to 25 August 2005 that came into force after the commencement date means that not all prices for non-standard services during the initial period were the same as those applying at 24 August 2005.

Powerco proposes the use of Publicly Reported Escapes ("PREs") and compliance with applicable industry quality standards to demonstrate compliance with clause 6 of the Notice requiring no material deterioration in quality of the controlled services.

Powerco will assist the Commerce Commission with its review of this compliance statement and will provide any additional information that may be required.

Powerco has publicly disclosed this statement by making it available at its principal office (Powerco, Level 2, 84 Liardet Street, New Plymouth), by providing the document on request and by publishing the document to Powerco's website (Powerco.co.nz). As required by the Notice Powerco has published in newspapers having the greatest number of copies distributed in the areas where our controlled services are supplied a brief summary of the *information referred to above* and the Uniform Resource Locator (URL) of the Internet site where that information can be found.

This statement was prepared and released on 9 November 2006. The Commerce Commission has made known to Powerco their interpretation of certain aspects of the Provisional Authorisation that differ from Powerco's interpretation. Powerco has agreed to alter this statement to reflect the Commerce Commission's interpretation and has re-released the statement dated 16 February 2006. As agreed with the Commerce Commission this Statement has not been audited.

## **2. PRICE THRESHOLD**

### **2.1 INITIAL PERIOD**

Clause 5(a)(i) of the Notice requires that throughout the initial period (25 August 2005 to 30 September 2005):

*"The price of each standard service must be the price determined in accordance with the standard contract that was in force on the day before the commencement date".*

Powerco has complied with the requirements of clause 5(a)(i).

Powerco's Use of System Agreements allow for only a single price change in any twelve-month period. The previous price change was 1 October 2004, which prevented Powerco from making any change to the price of its standard services prior to 1 October 2005.

Clause 5(a)(ii) requires that:

*"the price of each non-standard service that was supplied on the commencement date must be the price determined in accordance with the non-standard contract for that service that was in force on the day before the commencement date".*

The commencement date for the Notice is 25 August 2005.

The intention of clause 5(a)(ii) is to ensure that Powerco does not undertake wholesale changes to the prices for non-standard services prior to the first assessment date, 1 October 2005. Powerco did not make any changes to the initial period prices of non-standard services in the period between 25 August 2005 and 1 October 2005. To this end Powerco complied with both the spirit and obvious intention of clause 5(a)(ii).

On 25 August 2005 Powerco had a single non-standard contract that expired on 30 August 2005. Powerco had offered contractual terms to begin from 1 September 2005. The offered contractual terms had been accepted by the Gas Retailers prior to 25 August 2005. Therefore the price that applied to this non-standard contract in the initial period was not that in force on 24 August 2005. Details of the non-standard contract are included in Attachment One - Non-Standard Contract.

The application of the standard price to the non-standard contract in question from 1 September 2005 would have been detrimental to the end consumer due to a significant rate increase.

Powerco has a significant number of non-standard contracts – approximately 380 contracts for network and GMS services. These non-standard contracts have a variety of expiry dates,

terms and review periods. Four Powerco employees spend a significant part of their days reviewing and administering these contracts. They are in a constant state of change.

As each non-standard contract nears expiry Powerco offers a new contract. The contract term can vary significantly, as can the starting date of the contract. On occasion, to assist a consumer, Powerco has made a contract offer that did not begin for nine months.

## 2.2 FIRST ASSESSMENT DATE

Powerco has complied with requirements of clause 5(b) of the Notice as measured at 1 October 2005.

Clause 5(b) of the Notice requires that:

*“the notional revenue of a controlled business at each assessment date is not to exceed the allowable notional revenue of the controlled business.”*

This is expressed algebraically as:

$$NR_t \leq AR_t$$

Where

$$NR_t = \sum_i P_{i,t}^t Q_{i,t}$$

$$AR_t = (1 - X) \sum_i P_{i,t} Q_{i,t}$$

- $P_{i,t}^t$  = prices in place at the reference date (30 June 2005)
- $P_{i,t}$  = prices in place at the assessment date (1 October 2005)
- X for the first assessment date is 9%.

Effectively the Notice requires that the volume-weighted prices in place at 1 October 2005 are 9% less than the volume-weighted prices in place at 30 June 2005.

Based on the strict application of the Notice threshold formula, as interpreted by the Commerce Commission, Powerco has reduced its notional revenue by 17.0%

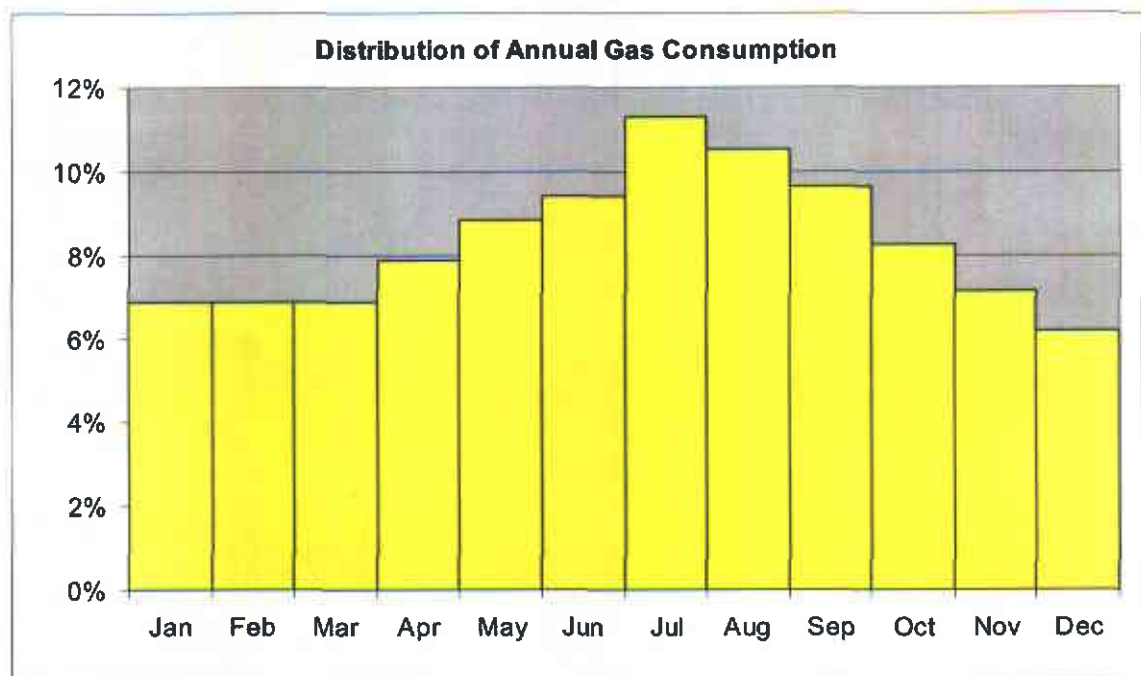
## 2.3 ANALYSIS

### 2.3.1 Technical Application

The Notice formula weights each price category or load group by the actual volume in the twelve-months to 30 June 2005 or the annualised volume from the most recent price change in the twelve-month period.

This formula creates three issues:

1. Powerco implemented price changes on 1 October 2004. Based on the calculation of the annualised volume ( $Q_i$ ) contained in the Notice, Powerco only refer to the period from 1 October 2004 to 30 June 2005. This annualization would ignore the heavy residential gas use months of July, August and, to a slightly lesser extent, September. This would reduce the volume associated with residential gas connections and therefore reduce the apparent "effect" of price reductions for residential consumers who have a particularly peaky winter load.



|   | <b>Residential</b><br>(Weather dependent<br>consumption) | <b>Commercial</b><br>(Flat consumption<br>profile) |
|---|--|--|
| July to September consumption                       | 40   | 30   |
| October to June consumption                         | 80   | 90   |
| Actual consumption                                  | 120  | 120  |
| Annualized volume if 1 October<br>2004 price change | = $80/274 \times 365$<br>= 107                           | = $90/274 \times 365$<br>= 120                     |

**Table 1 Fictitious Example of How Notice Annualization Calculation Understates Residential Consumption**

2. Calculating notional revenue based on quantities applicable to historic load groups is problematic where the load group structure is altered.

| Load Group       | Historic Volume | Historic Price | Historic Revenue | New Price | New Revenue |
|------------------|-----------------|----------------|------------------|-----------|-------------|
| A (continued)    | 100             | \$1.00         | \$100            | 0.91      | \$91        |
| B (discontinued) | 80              | \$1.50         | \$120            | N/A       | N/A         |
| C (new)          | N/A             | N/A            | N/A              | \$1.45    | N/A         |
| Totals           |                 |                | \$220            |           | \$91        |

Table 2 – Fictitious Example of Effect of Load Group Adjustment

3. The cyclical nature of meter reading makes it impractical for Retailers to provide completely accurate figures for consumption for each Point of Connection (or ICP) in the timeframe required to calculate line charges. To this end Powerco has an agreed wash-up and reconciliation process with Retailers that require them to resubmit accurate ICP volumes. A six-month and twelve-month wash-up process is undertaken that recalculates line charges for that month. This means that the quantities used to calculate the allowable notional revenue and the notional revenue under the Notice formula remain tentative for any month within the wash-up timeframes e.g. all quantities from August 2004 to June 2005 require at least one wash-up.

Powerco has assessed its notional revenue at 1 October 2005 against its allowable notional revenue, based on the strict application of the Notice as interpreted by the Commerce Commission. The Commerce Commission has interpreted the Provisional Notice such that Powerco's load groups (G08 and G10) which were discontinued on 1 October 2005 do not form part of the notional revenue calculation.

Powerco has based the technical application of the Notice formula on information to hand as at 7 September 2005, being the date that the prices for the forthcoming pricing year (1 October 2005) were set. Technical application of the Notice formula at 1 October 2005 gives:

|  |                     |
|--|---------------------|
| <b>Allowable Notional Revenue (AR<sub>2005</sub>)</b>      | (\$ million)        |
| (1 - X)  | (1-0.09)            |
| $\sum_i P_{i 2005} Q_{i 2005}$                             | 19.07               |
| $(1 - X) \sum_i P_{i 2005} Q_{i 2005}$                     | 17.35               |
| <b>Notional Revenue (NR<sub>2005</sub>)</b>                | 15.83               |
| $\sum_i P_{i 2005} Q_{i 2005}$                             |                     |
| $\frac{NR_{2005}}{AR_{2005}} = \frac{15.83}{17.35} = 0.91$ | therefore No Breach |

Table 3 - Technical Application of Formula